

# CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 268

September 17, 1964

## UNITARY BUSINESS: DISTINGUISHING CHARACTERISTICS

### Syllabus:

Taxpayer operates television and radio networks which are on the air 18 hours a day. These networks sell time to sponsors. By picking the proper time of day, the sponsor can reach the maximum number of people likely to buy its product. If polls indicate that the sponsor's program has an insufficient audience, the sponsor will drop the program.

In order to obtain sponsors, the networks try to reach as many people as possible. A network of about 200 television stations and over 200 radio stations can contact over 98% of the population. Since the Federal Communications Commission severely limits the number of stations a network may own or control, the overwhelming majority of the stations carrying network programs are independent affiliates. The networks, themselves, attempt to gain ownership of outlets in major population centers. Five well placed stations can reach about 25% of the people, if fringe reception is counted.

The major sources of revenue of stations carrying network programs are national spot advertising and the sale of local time. Stations carrying taxpayer's programs obtain national spot advertising independently from the network. Credits received from the network are only a minor source of income for these stations.

X, a wholly owned subsidiary of taxpayer, owns and operates radio and television station S in Ohio. Some of the subsidiary's officers are also officers or employees of taxpayer. During each of the years 1954 and 1955, X paid taxpayer a management fee. The fee was not based on the value of services rendered. The day to day operation of station S is conducted largely independently from the control of taxpayer.

The method of operation of station S is substantially the same as that of taxpayer's own stations in California and Illinois. The rate of compensation paid to station S or an independent station in a comparable location, is about the same. It is contended that station S was more efficiently managed than the balance of the network's operation.

Should the income of S be included in the unitary income of taxpayer? A business is unitary if the portion of the business operating within the state is dependent upon or contributes to the business operating without the state. Edison

California Stores, Inc. v. McColgan, 30 Cal. 2d 472, 481.

In the present case taxpayer owns all the stock of X and supplies some of the subsidiary's officers, as well as management services. Thus, general policy is coordinated and the subsidiary is able to add the parent's know-how to its own abilities. Carrying network programs enables the station to obtain revenue from national spot advertising and the sale of local time, which it would not otherwise get. An independent affiliate can lose its network programs at the close of the contract period. An owned or controlled station is not subject to this contingency. The station benefits from its relationship with taxpayer.

On the other hand the network benefits from the presence of a station in a major population center. The more people the network reaches, the more attractive it becomes to sponsors. The presence of S brings the network income from sponsors, which would otherwise be unavailable. Exactly how much one individual station adds to taxpayer's income is undeterminable. Having an owned station is superior to having an independent affiliate, since an owned station cannot switch networks. Thus the required interdependence exists.

An additional factor is two of taxpayer's owned stations are operated substantially the same as S, and are conceded to be part of the unitary business. Differences in the income caused by the use of the formula or separate accounting and differences in efficiency are not sufficient to overcome a determination that the business is unitary. Edison California, Inc., v. McColgan, supra; John Deere Plow Co. v. Franchise Tax Board, 38 Cal. 2d 214.